

Multistate Tax Commission



TO: MICHAEL SOUTHCOMBE, CHAIRMAN OF THE EXECUTIVE
COMMITTEE

TED SPANGLER, CHAIRMAN OF THE
UNIFORMITY COMMITTEE OF THE MTC

FROM: ALAN H. FRIEDMAN, MODERATOR
PPWG-UNIFORMITY COMMITTEE LIAISON GROUP

SUBJECT: UNITARY BUSINESS DEFINITIONS

DATE: JULY 15, 1999

As Moderator of the PPWG-Uniformity Committee Liaison Group (the "Group"), I am transmitting to you the following materials:

1. Draft dated July 15, 1999 of a
Dependency/Contribution Test for a Unitary Business.
2. Draft dated July 15, 1999 of a Three Unities Test for a
Unitary Business.

The goal of the Group was to attempt to develop definitions for a "unitary business". To this end, the Group first sought to establish such definitions under the three traditional tests that have been adopted in the various states - Dependency/Contribution Test, Three Unities Test and the *Mobil* Factors Test. It was agreed to among the members of the Group that if various provisions were in dispute, that each such provision would be set forth in its alternative. In this manner, those reviewing the work product could get a sense for the differing approaches the experts in this Group thought were supported in law and viable.

The Group and certain Subgroups met only by teleconference and 17 such teleconferences were publicly notice and held. I refer you to the Multistate Tax Commission web site, www.mtc.gov, for the specific public notices and agendas that were set forth for the teleconferences, as well as the many documents that were generated by the Group. A further description of this effort follows.

Brief Historical Perspective

During 1996, 1997 and 1998, the MTC worked with taxpayer representatives in an effort to develop uniform definitions for two important state tax concepts – (1) business/nonbusiness income and (2) a unitary business. That effort was called the Public Participation Working Group to reflect the desires of the MTC and of taxpayer representatives to work together in the development of a common set of definitions for the common good.

Many meetings and telephone discussions were had regarding these two topics, but no consensus¹ was reached as to either definitional effort. The business/nonbusiness definition was the most contentious of the two efforts, as business and state representatives were at odds as to whether two definitions income – the transactional and the functional – existed for the concept of business or just one, the transactional. The Executive Committee agreed to suspend work by the PPWG on the “business/nonbusiness income” definition; but permitted additional effort to continue with respect to seeking an acceptable definition of what constitutes a “unitary business”.

Current Effort

Since February of 1999, a hardy band of folks, the majority of which were state representatives, has met by teleconference in an effort to develop a variety of alternative definitions of a unitary business. This group has been referred to as the “PPWG-Uniformity Committee Liaison Group”, as its membership comprised of state representatives and a taxpayer representative who agreed to work with one another on this project in order to provide the Uniformity Committee with their best thoughts in this area. The product of this joint effort is now being provided by the attachments to the Executive and to Uniformity Committees of the MTC for their review, input, and direction.

There were only three principal ground rules for the operation of the PPWG-Uniformity Committee Liaison Group. The first was that no consensus in support of any recommendation of the Group was being sought. The Group merely committed to use its best professional effort to discuss and refine alternative definitions for what constitutes a “unitary business”. Second, there would be no personal attribution to

¹ A mighty high bar was set in the definition of the term “consensus”. That term was defined as requiring that degree of agreement in which there would be no one working on the project that would feel compelled, upon the Group’s reaching a result, to work outside the group effort to defeat the result in any other forum.

any member of the Group of any specific comments, suggestions, language drafts or the like, unless that person wished to have such attribution. And, third, if any member of the Group felt strongly enough for a given position, that position, without further question or condition, would be set forth in the draft as an alternative position, leaving it to a subsequent review or body, such as the Uniformity Committee or the MTC rule-making process, to select between the alternatives presented.

It should be emphasized that the attached drafts reflect that (1) alternative positions as noted above are set forth for consideration with respect to certain provisions in the Dependency/Contribution Test and the Three Unities Test; and (2) both the drafts are incomplete in some respects. To date, work directly on the third definition of a unitary business – the *Mobil* Factors Test – has not yet been initiated.

While each of the attached drafts sets forth its test in a fairly detailed fashion, neither has a completely polished finish, both requiring additional thought and work.² You will note the appearance of identical provisions (Presumptions and General Rules) that in all of the drafts, irrespective of whether the Dependency/Contribution Test(s) or the Three Unities Test is being articulated. In this fashion, the differences in results between applications of the various tests may be reduced somewhat; and this is a salutary beginning in my opinion.

² For example, one thoughtful participant has noted that –

“Both the Dependency/Contribution Test and the Three Unities Test start with a definition of “Business” that requires two or more entities to be “under common ownership or control.” The Dependency/Contribution Test says nothing more about this requirement whereas the Three Unities Test goes into great detail about unity of ownership. Of course, all of this is of consequence only to the combination states; but in the combination states it is of equal consequence to those that use the Dependency/Contribution Test and those that use the Three Unities Test. I am wondering if the ownership provisions could be put into a separate section that can be appended to either test by a combination state and ignored by a non-combination state.

Suggestions, such as this one, need to be reviewed and worked with to improve upon the PPWG-Liaison Group effort even further.

One noted expert expressed during our last teleconference that there now appears less of a reason to work specifically on the *Mobil* Factors Test, because many concepts contained in that test have been fleshed out in the Dependency/Contribution and Three Unities Tests. The Group has brought these two definitions most of the way home; but a more widespread, in-depth review is now necessary to put the finishing refinements in place before they are offered for a more public review. When that work is completed, it may be a relatively easy matter to then articulate the *Mobil* Factors Test in a manner that is quite consistent with the other two tests.

Recommendations

The Moderator believes that this Group has successfully more than kick-started this very important voluntary effort; and the Group has engaged in a high level of discussion that is a tribute to the professionalism of its members. Those participating in the Group should be commended for their interest, attentiveness, and contribution to this effort. I also believe that it is important to the ultimate success of this effort to (1) expose the drafts and spread the work to a wider group of state tax professionals; and (2) obtain the assistance of MTC staff in the final drafting of the test or tests to be presented in any future public forum or hearing. Based upon these conclusions, the Moderator recommends that:

1. The MTC staff develops a more complete draft of the Dependency/Contribution and Three Unities Tests, as well as an initial draft of the third test – the *Mobil* Factors Test – which should be based upon the relevant provisions found in the attached drafts of the other two tests. In drafting the *Mobil* Factors Test, staff should utilize, where relevant and appropriate, the identical language found in the other two tests.
2. Upon completion of the staff draft of the *Mobil* Factors Test, all completed drafts of the three tests should first be distributed to all of the members of the PPWG-Uniformity Committee Liaison Group; and upon proper published notice, that Group should be given the opportunity to make suggestions and provide such other input as it wishes regarding that initial draft.
3. Upon the receipt of such input from the Group, the *Mobil* Factors Test draft should be transmitted to the Uniformity

Committee for its further consideration, along with the drafts of the other two tests.

4. The Uniformity Committee should then determine which, if any, of the following alternatives will best advance the widespread state adoption of an appropriate and uniform definition of a “unitary business”:
 - a. The adoption of an MTC rule setting forth the recommended uniform statutory/regulatory definitions to be used if a state is to apply any one or more of the three definitions for a unitary business now available – the Dependency/Contribution, Three Unities, and *Mobil* Factors tests; or,
 - b. The adoption of an MTC rule setting forth only one recommended uniform statutory/regulatory definition, which definition is selected from among the current three definitions now available; or,
 - c. The adoption of an MTC rule setting forth only one recommended uniform statutory/regulatory definition, which definition is derived from an appropriate amalgamation of the principal components or concepts currently found in the three definitions now available; or,
 - d. The adoption of such other action deemed appropriate.

You will note that I am specifically not recommending further drafting work be done by the Group, other than seeking whatever contributions it wishes to make when a more finalized version of the tests have been prepared. The contributions from non-governmental members of the Group were thoughtful, significant and substantive; however, there was, in my opinion, an insufficient number of non-governmental participants consistently participating in the process to result in a reasonably widespread articulation of the private sectors’ thoughts.³ I believe that a new public forum or rulemaking hearing will generate such input from the business community, as well as from additional states.

³ Early in this process, the Moderator was justly accused of setting unreasonably short time frames for the development of the Dependency/Contribution Test. The throttle was then adjusted for development of the Three Unities Test; however, by that time we had already lost participation from some members of the private sector due to the maniacal pace the project was perceived as following. Fortunately, those who hung on were more used to the self-flagellation that a project such as this requires.

It was my pleasure to facilitate the teleconference discussions and workflow of the Group. Should you wish my further involvement, please do not hesitate to call upon me.

**PROPOSED DEFINITION ONE OF DEPENDENCY/CONTRIBUTION
TEST
JULY 15, 1999**

(DISJUNCTIVE)

**I. **Dependency/Contribution Test for Determining Unitary
Business****

A. Definitions.

For the purposes of this section, the following definitions shall apply and control:

1. “Business” means a single entity or two or more entities under common ownership or control with respect to which [this State’s income/franchise tax] law requires a determination of whether the activities of the entity or entities within and without this State constitute one or more unitary businesses within this State.
2. “Entity” means each type of organization that [this State’s income/franchise law] recognizes as a reporting person, except such term does not include an individual or [insert other applicable exceptions].
3. “Segment” means a subdivision of an entity consisting of any grouping of business activities, functions or transactions.

B. Dependency/Contribution Test.

1. An entity or segment of a business is part of a unitary business with (i) each other entity or segment upon which it is dependent or to which it contributes; and with (ii) each other entity or segment which is dependent upon or contributes to any other entity or segment which is part of the unitary business.
2. In order to satisfy this test, the operations of the entities and segments need not be (i) interdependent or of mutual benefit to one another, (ii) nor essential or necessary to the operations of one another.

C. Facts and Circumstances; Presumptions; General Rules.

The determination under paragraph B. of whether an entity or segment forms part of a unitary business with another shall be determined by the facts and circumstances of each case. It shall be presumed, subject to rebuttal, that sufficient dependency or contribution exists between entities or segments under paragraph B. to form a unitary business when one or more of the following factors are present:

1. *Same General Line of Business; Presumption.* When the principal activities of the entities or segments are in the same general line of business. Illustrations of the same general line of business, but not limitations, are manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance.
 - a. In determining whether two entities or segments are in the same general line of business, consideration shall be given to the nature and character of the basic operations of each entity or segment, including, but not limited to, sources of supply, goods or services produced or sold, labor force and market.
 - b. Two entities or segments are in the same general line of business when their operations are sufficiently similar to reasonably conclude that the entities or segments are likely to depend upon or contribute to one another.
2. *Vertically Structured Business; Presumption.* When the entities or segments are engaged in different steps of a vertically structured business. Illustrations of such different steps, but not limitations, are exploration, mining/drilling, production, refining, marketing, and/or transportation of natural resources.
3. *Strong Centralized Management; Presumption.* When there exists a strong centralized management among the entities or segments. Illustrations of such management, but not limitations, are executive level policy decisions in the areas of purchasing, accounting, financing, tax compliance, legal services, human resources, health/retirement plans, product lines, capital investment, marketing and the like are determined by a

central person or persons or committee and not by each entity or segment.

4. *Segments within the Same Entity; Presumption.* When the business segments are in the same entity.

[Note: There was support expressed to eliminate this subparagraph 4. as possibly duplicative of the other three subparagraphs, especially subparagraph 3.]

5. *General Rules.* In order to determine whether the facts and circumstances of any given case support a conclusion that an entity or segment is unitary with another under the Dependency/Contribution Test, the following additional general rules shall apply:

- a. *Existence of Arms'-Length Prices.* The fact that goods and/or services are supplied at arms'-length prices between or among entities or segments of entities sought to be included in or excluded from a unitary business is

[ALTERNATIVE A] not a relevant fact, and does not support either inclusion in or exclusion from a unitary business group.

[ALTERNATIVE B] a relevant fact that is in support of exclusion from a unitary business group.

- b. *Non-Existence of Arms'-Length Prices.* The fact that goods and/or services are not supplied at arms'-length prices between or among entities or segments of entities sought to be included in or excluded from a unitary business is relevant, and is a fact that is in support of inclusion in a unitary business group.
- c. *Existence of Benefits from Joint, Shared or Common Activity.* The fact that a discount, cost-saving or other benefit can be shown to result from joint purchases, leaseholds or other forms of joint, shared or common activities between or among entities or segments of entities is

relevant, and is a fact that is in support of inclusion in a unitary business group.

- d. *Non-Existence of Benefits from Joint, Shared or Common Activity.* The fact that a discount, cost-saving or other benefit cannot be shown to result from joint purchases, leaseholds or other forms of joint, shared or common activities between or among entities or segments of entities is not relevant, and is not a fact in support of either inclusion in or exclusion from a unitary business group.
- e. *Relationship of Joint, Shared or Common Activity to Income-Producing Operations.* In determining whether a joint, shared, or common activity is a fact that does or does not support a finding regarding unitary, consideration shall be given to the nature and character of the basic operations of each entity or segment. Such consideration shall include, but not be limited to, the entities' and segments' sources of supply, their goods or services produced or sold, their labor force and market to determine whether the joint, shared or common activity is directly beneficial to, related to or reasonably necessary to the income-producing activities of the unitary business.
- f. *The Existence or Lack of Control.*

[ALTERNATIVE A] The fact that control by one entity or segment over another entity or segment exists is relevant and is a fact in support of inclusion in a unitary business group.

[ALTERNATIVE B] The fact that control by one entity or segment over another entity or segment does not exist is relevant and is a fact in support of exclusion from a unitary business group.

[Alternatives A and B are to be coupled].

[ALTERNATIVE C] The fact that one entity or segment either exercises control or does not exercise control over another entity or segment is a fact to be taken into consideration in evaluating the significance of joint, shared, or common activity.

- g. *Stewardship Activities.* An investor who takes an action solely for its own benefit in overseeing its investment and which action is not taken to benefit the entity in which the investor owns an interest, shall be considered to be a “stewardship” activity. The fact that stewardship activities exist is not relevant to determining whether the elements of “unity of operations” or “unity of use” have been satisfied.
- h. *Holding Companies and Diverse Businesses.* The test for a unitary business established hereunder shall be applied to determine whether a holding company is to be included in or excluded from a unitary group and to whether diverse businesses are to be included in or excluded from a unitary group. This provision applies irrespective of whether the holding company is an active or passive holding company.
- i. *Instant Unity; Presumptions*
 - (1) Newly-Acquired Corporations. When a corporation acquires another corporation, a presumption shall exist against a finding of unity between the two corporations during the first reporting period. Any party may rebut such presumption by proving that the corporations were unitary. If such presumption is rebutted, then the corporations shall be considered unitary as of the date of acquisition, unless the evidence shows that unity was established as of another date.
 - (2) Newly-Formed Corporations. When a corporation forms another corporation, a presumption shall exist in favor of finding unity between the two corporations as of the date of

formation. Any party may rebut such presumption by proving that the corporations were not unitary or that unity was established as of a later date.

D. Illustrations.

The above principles are illustrated by the following examples:

Example 1: Corporation A has an ownership interest in Corporations B, C, and D. Corporation A is dependent upon or contributes to Corporation C. Corporation C is dependent upon or contributes to Corporation D. Corporation B does not contribute to and is not dependent upon Corporations A, C, or D. In this example, Corporations A, C, and D constitute a unitary business. This is the result even though Corporation A is not directly dependent upon and does not directly contribute to Corporation D.

Example 2: Corporation A has an ownership interest in Corporations B, C, and D. Corporation A consists of Segments A1, A2, and A3. The presumption that A1, A2, and A3 are part of a unitary business has not been successfully rebutted. Segment A1 is dependent upon or contributes to Corporation C. Corporation C is dependent upon or contributes to Corporation D. Corporation B does not contribute to and is not dependent upon Corporations A (or any of its segments), C, or D. In this example, Corporations A (including each of its segments), C, and D constitute a unitary business.

Example 3: Same as Example 2, except that the presumption that Segment A3 is part of a unitary business with the other segments of Corporation A has been successfully rebutted. Furthermore, Segment A3 does not contribute to and is not dependent upon Corporations C or D. In this example, Corporations A (including Segments A1 and A2), C, and D constitute a unitary business.

PROPOSED DEFINITION TWO OF
DEPENDENCY/CONTRIBUTION TEST
JULY 15, 1999

(CONJUNCTIVE)

I. **Dependency/Contribution Test for Determining Unitary Business**

A. Definitions.

For the purposes of this section, the following definitions shall apply and control:

1. “Business” means a single entity or two or more entities under common ownership or control with respect to which [this State’s income/franchise tax] law requires a determination of whether the activities of the entity or entities within and without this State constitute one or more unitary businesses within this State.
2. “Entity” means each type of organization that [this State’s income/franchise law] recognizes as a reporting person, except such term does not include an individual or [insert other applicable exceptions].
3. “Segment” means a subdivision of an entity consisting of any grouping of business activities, functions or transactions.

B. Dependency/Contribution Test.

1. An entity or segment is part of a unitary business with (i) each other entity or segment upon which it is dependent or to which it contributes; and with (ii) each other entity or segment which is dependent upon or contributes to any other entity or segment which is part of the unitary business.
2. In order to satisfy this test, the entities and segments must be interdependent or of mutual benefit to one another; however, the operation of any one entity or segment need not (i) contribute to or depend upon the operation of all other entities or segments; nor (ii) be

essential or necessary to the operation of any other entity or segment.

C. Facts and Circumstances; Presumptions.

The determination under paragraph B. of whether an entity or segment forms part of a unitary business with another shall be determined by the facts and circumstances of each case. It shall be presumed, subject to rebuttal, that sufficient dependency or contribution exists between entities or segments under paragraph B. to form a unitary business when one or more of the following factors are present:

1. *Same General Line of Business; Presumption.* When the principal activities of the entities or segments are in the same general line of business. Illustrations of the same general line of business, but not limitations, are manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance.
 - a. In determining whether two entities or segments are in the same general line of business, consideration shall be given to the nature and character of the basic operations of each entity or segment, including, but not limited to, sources of supply, goods or services produced or sold, labor force and market.
 - b. Two entities or segments are in the same general line of business when their operations are sufficiently similar to reasonably conclude that the entities or segments are likely to depend upon or contribute to one another.
2. *Vertically Structured Business; Presumption.* When the entities or segments are engaged in different steps of a vertically structured business. Illustrations of such different steps, but not limitations, are exploration, mining/drilling, production, refining, marketing, and/or transportation of natural resources.
3. *Strong Centralized Management; Presumption.* When there exists a strong centralized management among the entities or segments. Illustrations of such management, but not limitations, are executive level policy decisions in the areas of purchasing, accounting, financing, tax

compliance, legal services, human resources, health/retirement plans, product lines, capital investment, marketing and the like are determined by a central person or persons or committee and not by each entity or segment.

4. *Segments within the Same Entity; Presumption.* When the business segments are in the same entity.

[Note: There was support expressed to eliminate this subparagraph 4. as possibly duplicative of the other three subparagraphs, especially subparagraph 3.]

5. *General Rules.* In order to determine whether the facts and circumstances of any given case support a conclusion that an entity or segment is unitary with another under the Dependency/Contribution Test, the following additional general rules shall apply:

- a. *Existence of Arms'-Length Prices.* The fact that goods and/or services are supplied at arms'-length prices between or among entities or segments of entities sought to be included in or excluded from a unitary business is

[ALTERNATIVE A] not a relevant fact, and does not support either inclusion in or exclusion from a unitary business group.

[ALTERNATIVE B] a relevant fact that is in support of exclusion from a unitary business group.

- b. *Non-Existence of Arms'-Length Prices.* The fact that goods and/or services are not supplied at arms'-length prices between or among entities or segments of entities sought to be included in or excluded from a unitary business is relevant, and is a fact that is in support of inclusion in a unitary business group.
- c. *Existence of Benefits from Joint, Shared or Common Activity.* The fact that a discount, cost-saving or other benefit can be shown to result from joint

purchases, leaseholds or other forms of joint, shared or common activities between or among entities or segments of entities is relevant, and is a fact that is in support of inclusion in a unitary business group.

- d. *Non-Existence of Benefits from Joint, Shared or Common Activity.* The fact that a discount, cost-saving or other benefit cannot be shown to result from joint purchases, leaseholds or other forms of joint, shared or common activities between or among entities or segments of entities is not relevant, and is not a fact in support of either inclusion in or exclusion from a unitary business group.
- e. *Relationship of Joint, Shared or Common Activity to Income-Producing Operations.* In determining whether a joint, shared, or common activity is a fact that does or does not support a finding regarding unitary, consideration shall be given to the nature and character of the basic operations of each entity or segment. Such consideration shall include, but not be limited to, the entities' and segments' sources of supply, their goods or services produced or sold, their labor force and market to determine whether the joint, shared or common activity is directly beneficial to, related to or reasonably necessary to the income-producing activities of the unitary business.
- f. *The Existence or Lack of Control.*

[ALTERNATIVE A] The fact that control by one entity or segment over another entity or segment exists is relevant and is a fact in support of inclusion in a unitary business group.

[ALTERNATIVE B] The fact that control by one entity or segment over another entity or segment does not exist is relevant and is a fact in support of exclusion from a unitary business group. [Alternatives A and B are to be coupled].

[ALTERNATIVE C] The fact that one entity or segment either exercises control or does not exercise control over another entity or segment is a fact to be taken into consideration in evaluating the significance of joint, shared, or common activity.

- g. *Stewardship Activities.* An investor who takes an action solely for its own benefit in overseeing its investment and which action is not taken to benefit the entity in which the investor owns an interest, shall be considered to be a stewardship” activity. The fact that stewardship activities exist is not relevant to determining whether the elements of “unity of operations” or “unity of use” have been satisfied.
- h. *Holding Companies and Diverse Businesses.* The test for a unitary business established hereunder shall be applied to determine whether a holding company is to be included in or excluded from a unitary group and to whether diverse businesses are to be included in or excluded from a unitary group. This provision applies irrespective of whether the holding company is an active or passive holding company.
- i. *Instant Unity; Presumptions*
 - (1) Newly-Acquired Corporations. When a corporation acquires another corporation, a presumption shall exist against a finding of unity between the two corporations during the first reporting period. Any party may rebut such presumption by proving that the corporations were unitary. If such presumption is rebutted, then the corporations shall be considered unitary as of the date of acquisition, unless the evidence shows that unity was established as of another date.
 - (2) Newly-Formed Corporations. When a corporation forms another corporation, a presumption shall exist in favor of finding unity between the two corporations as of the date of

formation. Any party may rebut such presumption by proving that the corporations were not unitary or that unity was established as of a later date.

D. Illustrations.

The above principles are illustrated by the following examples:

Example 1: Corporation A has an ownership interest in Corporations B, C, and D. Corporation A is dependent upon or contributes to Corporation C. Corporation C is dependent upon or contributes to Corporation D. Corporation B does not contribute to and is not dependent upon Corporations A, C, or D. In this example, Corporations A, C, and D constitute a unitary business. This is the result even though Corporation A is not directly dependent upon and does not directly contribute to Corporation D.

Example 2: Corporation A has an ownership interest in Corporations B, C, and D. Corporation A consists of Segments A1, A2, and A3. The presumption that A1, A2, and A3 are part of a unitary business has not been successfully rebutted. Segment A1 is dependent upon or contributes to Corporation C. Corporation C is dependent upon or contributes to Corporation D. Corporation B does not contribute to and is not dependent upon Corporations A (or any of its segments), C, or D. In this example, Corporations A (including each of its segments), C, and D constitute a unitary business.

Example 3: Same as Example 2, except that the presumption that Segment A3 is part of a unitary business with the other segments of Corporation A has been successfully rebutted. Furthermore, Segment A3 does not contribute to and is not dependent upon Corporations C or D. In this example, Corporations A (including Segments A1 and A2), C, and D constitute a unitary business.

PROPOSED THREE UNITIES TEST

July 15, 1999 Draft

I. Three Unities Test for Determining a Unitary Business.

A. Definitions.

For the purposes of this section, the following definitions shall apply and control:

1. “Business” means a single entity or two or more entities under common ownership or control with respect to which [this State’s income/franchise tax] law requires a determination of whether the activities of the entity or entities within and without this State constitute one or more unitary businesses within this State.
2. “Entity” means each type of organization that [this State’s income/franchise law] recognizes as a reporting person, except such term does not include an individual or [insert other applicable exceptions].
3. “Segment” means a subdivision of an entity consisting of any grouping of business activities, functions or transactions.

B. Three Unities Test.

A unitary business includes each entity or segment of a business among which there exists a unity of ownership and a unity of operation or a unity of use, or both.

ALTERNATIVE A – MORE GENERAL TEST OF UNITY OF OWNERSHIP

The “unity of ownership” element of this test for combined reporting purposes is satisfied when an entity, directly or indirectly, owns more than a fifty percent (50%) ownership interest in each entity sought to be included in the unitary business.⁴

⁴ The unity of ownership element may be satisfied for apportionment of income purposes even though an entity owns less than a 50+% ownership in the entity sought to be included in the unitary business.

**ALTERNATIVE B – CALIFORNIA’S STATUTORY APPROACH TO
UNITY OF OWNERSHIP OR CONTROL**

**[TO BE TAILORED TO FORMAT OF REST OF
PROVISIONS]**

**STATE-LAW, CA-TAXRPTR ¶228-339, Sec.
25105. [Determination of ownership or control.]**

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**[California Laws], REVENUE AND TAXATION CODE,
DIVISION 2--OTHER TAXES, PART 11. BANK AND
CORPORATION TAX LAW, CHAPTER 17 ALLOCATION OF
INCOME, Article 1 General Provisions.**

Sec. 25105. [Determination of ownership or control.]

(a) For purposes of this article, other than Section 25102⁵, the income and apportionment factors of two or more corporations shall be included in a combined report only if the corporations, otherwise meeting the requirements of Section 25101 or 25101.15, are members of a commonly controlled group.

(b) A "commonly controlled group" means any of the following:

(1) A parent corporation and any one or more corporations or chains of corporations, connected through stock ownership (or constructive ownership) with the parent, but only if--

(A) The parent owns stock possessing more than 50 percent of the voting power of at least one corporation, and, if applicable,

(B) Stock cumulatively representing more than 50 percent of the voting power of each of the corporations, except the parent, is owned by the parent, one or more corporations described in subparagraph (A), or one or more other corporations that satisfy the conditions of this

4. Section 25102 permits or requires the FTB to permit the finding of unity of ownership when parties are found to be acting in concert with one another.

subparagraph.

(2) Any two or more corporations, if stock representing more than 50 percent of the voting power of the corporations is owned, or constructively owned, by the same person.

(3) Any two or more corporations that constitute stapled entities.

(A) For purposes of this paragraph, "stapled entities" means any group of two or more corporations if more than 50 percent of the ownership or beneficial ownership of the stock possessing voting power in each corporation consists of stapled interests.

(B) Two or more interests are stapled interests if, by reason of form of ownership restrictions on transfer, or other terms or conditions, in connection with the transfer of one of the interests the other interest or interests are also transferred or required to be transferred.

(4) Any two or more corporations, all of whose stock representing more than 50 percent of the voting power of the corporations is cumulatively owned (without regard to the constructive ownership rules of paragraph (1) of subdivision (e)) by, or for the benefit of, members of the same family. Members of the same family are limited to an individual, his or her spouse, parents, brothers or sisters, grandparents, children and grandchildren, and their respective spouses.

(c)(1) If, in the application of subdivision (b), a corporation is eligible to be treated as a member of more than one commonly controlled group of corporations, the corporation shall elect to be treated as a member of only one commonly controlled group. This election shall remain in effect unless revoked with the approval of the Franchise Tax Board.

(2) Membership in a commonly controlled group shall be treated as terminated in any year, or fraction thereof, in which the conditions of subdivision (b) are not met, except as follows:

(A) When stock of a corporation is sold, exchanged, or otherwise disposed of, the membership of a corporation in a commonly controlled group shall not be terminated, if the

requirements of subdivision (b) are again met immediately after the sale, exchange, or disposition.

(B) The Franchise Tax Board may treat the commonly controlled group as remaining in place if the conditions of subdivision (b) are again met within a period not to exceed two years.

(d) A taxpayer may exclude some or all corporations included in a "commonly controlled group" by reason of paragraph (4) of subdivision (b) by showing that those members of the group are not controlled directly or indirectly by the same interests, within the meaning of the same phrase in Section 482 of the Internal Revenue Code. For purposes of this subdivision, the term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised.

(e) Except as otherwise provided, stock is "owned" when title to the stock is directly held or if the stock is constructively owned.

(1) An individual constructively owns stock that is owned by any of the following:

(A) His or her spouse.

(B) Children, including adopted children, of that individual or the individual's spouse, who have not attained the age of 21 years.

(C) An estate or trust, of which the individual is an executor, trustee, or grantor, to the extent that the estate or trust is for the benefit of that individual's spouse or children.

(2) Stock owned by a corporation, or a member of a controlled group of which the corporation is the parent corporation, is constructively owned by any shareholder owning stock that represents more than 50 percent of the voting power of the corporation.

(3) Stock owned by a partnership is constructively owned by any partner, other than a limited partner, in proportion to the partner's capital interest in the partnership. For this purpose, a partnership is treated as owning proportionately the stock owned by any other

partnership in which it has a tiered interest, other than as a limited partner.

(4) In any case where a member of a commonly controlled group, or shareholders, officers, directors, or employees of a member of a commonly controlled group, is a general partner in a limited partnership, stock held by the limited partnership is constructively owned by a limited partner to the extent of its capital interest in the limited partnership.

(f) For purposes of this section, each of the following shall apply:

(1) "Corporation" means a subchapter S corporation, any other incorporated entity, or any entity defined or treated as a corporation pursuant to Section 23038 or 23038.5.

(2) "Person" means an individual, a trust, an estate, a qualified employee benefit plan, a limited partnership, or a corporation.

(3) "Voting power," means the power of all classes of stock entitled to vote that possess the power to elect the membership of the board of directors of the corporation.

(4) "More than 50 percent of the voting power" means voting power sufficient to elect a majority of the membership of the board of directors of the corporation.

(5) "Stock representing voting power" includes stock where ownership is retained but the actual voting power is transferred in either of the following manners:

(A) For one year or less.

(B) By proxy, voting trust, written shareholder agreement, or by similar device, where the transfer is revocable by the transferor.

(g) The Franchise Tax Board may prescribe any regulations as may be necessary or appropriate to carry out the purposes of this section, including, but not limited to, regulations that do the following:

(1) Prescribe terms and conditions relating to the election described by subdivision (c), and the revocation thereof.

(2) Disregard transfers of voting power not described by paragraph (5) of subdivision (f).

(3) Treat entities not described by paragraph (2) of subdivision (f) as a person.

(4) Treat warrants, obligations convertible into stock, options to acquire or sell stock, and similar instruments as stock.

(5) Treat holders of a beneficial interest in, or executor or trustee powers over, stock held by an estate or trust as constructively owned by the holder.

(6) Prescribe rules relating to the treatment of partnership agreements which authorize a particular partner or partners to exercise voting power of stock held by the partnership.

(h) This section shall apply to income years beginning on or after January 1, 1995.

(As amended by Ch. 1243, Laws 1994; Ch. 605, Laws 1997, applicable retroactively to income years beginning on or after January 1, 1955.)

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ALTERNATIVE C – UTAH’S STATUTORY APPROACH TO UNITY OF OWNERSHIP

[TO BE TAILORED TO FORMAT OF REST OF PROVISIONS]

(1) (a) "Common ownership" means the direct or indirect control or ownership of more than 50% of the outstanding voting stock of:

- (i) a parent-subsidiary controlled group as defined in Section 1563, Internal Revenue Code, except that 50% shall be substituted for 80%;

- (ii) a brother-sister controlled group as defined in Section 1563, Internal Revenue Code, except that 50% shall be substituted for 80%; or
- (iii) three or more corporations each of which is a member of a group of corporations described in Subsection (2)(a)(i) or (2)(a)(ii), and one of which is:
 - (A) a common parent corporation included in a group of corporations described in Subsection (2)(a)(i); and
 - (B) included in a group of corporations described in Subsection (2)(a)(ii).

* * * *

(2) (a) "Affiliated group" means one or more chains of corporations that are connected through stock ownership with a common parent corporation that meet the following requirements:

- (i) at least 80% of the stock of each of the corporations in the group, excluding the common parent corporation, is owned by one or more of the other corporations in the group; and
- (ii) the common parent directly owns at least 80% of the stock of at least one of the corporations in the group.

(b) "Affiliated group" does not include corporations that are qualified to do business but are not otherwise doing business in this state.

(c) For purposes of this subsection, "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(Cf., Utah Code Ann. § 59-7-101 (7) and (2))

The following examples illustrate the types of factual circumstances that may or may not satisfy the “unity of ownership” element of this test. These examples are for illustrative purposes only and do not limit the number or types of factual circumstances that exist that may or may not satisfy this element:

- a. Pulpwood Furniture, Inc. (“P”) has purchased 50.1% of the outstanding voting shares of Sapwood Manufacturing Co., Inc. (“S”). For purposes of the “unity of ownership” requirement, P directly owns more than a 50% ownership interest of S.
- b. Instead of directly purchasing stock in S, P purchases 80% of the outstanding shares of a Middle Co., Inc., which owns 70% of the outstanding shares of S. For purposes of the “unity of ownership” requirement, P indirectly owns more than a 50% ownership interest of S.

[ALTERNATIVE A (CA): P is considered as indirectly owning 70% of the voting interest of S.]

[ALTERNATIVE B: P is considered as indirectly owning 56% (80% x 70%) of the voting interest of S.]

- c. Same facts as in b. above, but P has purchased only 51% of Middle Co., Inc. which, in turn owns 70% of S.

[ALTERNATIVE 1 (CA): For purposes of the “unity of ownership” requirement, P indirectly owns more than a 50% ownership interest of S. P is considered as indirectly owning 70% of the shares of S.]

[ALTERNATIVE 2: For purposes of the “unity of ownership” requirement, P indirectly owns less than a 50% ownership interest of S. P is considered as indirectly owning 35.7% (50.1% x 70%) of the shares of S.]

- d. Same facts as in b. above, except that P has agreed with the minority shareholders of S that it would assign to an independent third person the right to vote all of P’s shares of Middle Co., so long as P was in the furniture business. P’s indirect ownership of more than 50% of S’s shares satisfies the “unity of ownership” test, even though P does not control S.
- e. P has purchased 50% of the outstanding shares of S and also holds warrants to purchase an additional 10% of S’s treasury shares at a nominal price.

[ALTERNATIVE A): P is treated as owning more than 50% of the ownership interest in S, even though it has yet to

exercise its right to purchase additional shares of S under its warrants.]

[ALTERNATIVE B]: P is treated as not owning more than 50% of the shares of S, because it has not yet exercised its right to purchase more shares under its warrants.]

2. The “unity of operations” element of this test is satisfied when each entity or segment within such entity that is to be included within the unitary business benefits or receives goods, services, support, guidance or direction arising from the actions of common staff resources, personnel, third-party providers, or operations under the direction of such common resources.

The following examples illustrate the types of factors, the existence or non-existence of which assists in the determination of whether the “unity of operations” element of this test has been satisfied. The existence or non-existence of any one factor, by itself, is normally not determinative of whether the element has or has not been satisfied. These examples are for illustrative purposes only and do not limit the number or types of factual circumstances that exist that may or may not satisfy this element:

- a. *Common purchasing:* Corporation P and its wholly owned subsidiary S are manufacturers of furniture; but P manufactures its own line of contemporary furniture and S manufactures reproductions of antique furniture. Both jointly purchase the wood pieces necessary for their production from the same company.
- b. *Common advertising:* Corporations P and S employ the same advertising firm that purchases advertising space in national magazines.
- c. *Common sales force:* Both P and S use the same independent contractor to sell their respective furniture lines to retailers around the United States.
- d. *Common accounting:* For most accounting purposes, P relies on its internal accounting department. S also uses P’s accounting.
- e. *Common legal support:* For most non-litigation purposes, P uses its in-house counsel. S also uses P’s in-house counsel for its non-litigation legal

needs. P's General Counsel oversees all litigation concerning P and its subsidiaries.

- f. *Common retirement plan:* P has created and adopted one joint retirement plan for employees of P and any of its subsidiaries.

P and S had different retirement plans. Instead of merging the two or terminating both retirement plans and creating another, P and S permit service in either entity to qualify as service under either plan.

- g. *Common insurance coverage:* After its acquisition, S's employees were required to enroll in P's health care plan and S's old plan was terminated.
- h. *Common marketing:* The internal marketing department of P provides all of the marketing requirements of both P and S.
- i. *Common cash management:* Both P and S maintain separate bank accounts for their operating fund needs. However, on a quarterly basis, P requires S to pay over to P's Treasurer all excess cash not needed for the operation of S's day-to-day operations. P's Treasurer then invests P's and S's excess cash in a mixture of short and long-term investments.
- j. *Common research and development:* Before P had acquired S, S had a highly accomplished research lab team that specialized in the development and use of various resins necessary in finishing of furniture. P had full access to the use of S's lab.
- k. *Common offices:* After acquiring S, P enlarged the premises of its lease for its offices to add another floor. P subleases the added floor to S.
- l. *Common manufacturing facilities:* After P acquired S, P moved a part of its lathing operation into the factory that S occupies. P then acquired additional space for manufacturing down the block from S's factory to maximize the efficiency of its lathing operation in S's building.
- m. *Common warehousing facilities:* P owns a warehouse in which it stores its entire inventory. After acquiring S, P permitted S to store some of its furniture production in the warehouse.

- n. *Common transportation facilities:* P and S use the same common carrier for their shipments of furniture. Due to the overall volume shipped by P and S, P is given a small discount by the carrier.
- o. *Common computer systems and support:* After its acquisition by P, S got rid of all of its typewriters and bought computer equipment that would network with P's. P's Information Systems people assisted in the integration of the two systems and now fully support S's systems and computer needs. S pays P for the cost of P's providing these computer services at an arms-length hourly rate.
- p. *Financing support:* In order to acquire S, P was required to take out a loan from its bank. The bank insisted on having S's assets pledged as additional collateral for the loan.

When required by bank officers, P would guarantee loans made to S.

3. The 'unity of use' element of this test is satisfied when each entity or segment within such entity that is to be included within the unitary business benefits or receives goods, services, support, guidance or direction arising from the actions of common line or executive resources, personnel, or operations under the direction of such common resources.

The following examples illustrate the types of factors, the existence or non-existence of which assists in the determination of whether the "unity of use" element of this test has been satisfied. The existence or non-existence of any one factor, by itself, is normally not determinative of whether the element has or has not been satisfied. These examples are for illustrative purposes only and do not limit the number or types of factual circumstances that exist that may or may not satisfy this element:

- a. *Common management:* One or more officers or directors of P are also officers or directors of
- b. *Control of major policies:* P's Board of Directors requires that it approve any acquisition by either P or S of any interest in any other company.

P's Board of Directors requires that it approve any lending of in excess of a minimum set amount to any one or more of either P or S's suppliers.

- c. *Inter-entity transactions*: S has licensed to P the use of a resin developed in S's lab. P uses the resin for its production.
- d. *Common policy/training manuals*: P's Employee Handbook has been expanded to apply to all of S's employees.

S's employees are required to attend P's employee training courses.

Disciplinary procedures are the same for both P and S's employees, although the appeal is only through their respective entities.
- e. *Required budgetary approval*: P's Board of Directors requires that it approve the budget and expenditure plans of S on an annual basis.
- f. *Required capital asset purchase approval*: P's Board of Directors requires that it approve any capital expenditure by S in excess of a minimum set amount.

C. Facts and Circumstances; Presumptions; General Rules.

1. *Facts and Circumstances*. The determination under paragraph B. of whether an entity or segment forms part of a unitary business with another shall be determined by the facts and circumstances of each case.
2. *General Rules*. In order to determine whether the facts and circumstances of any given case support a conclusion that an entity or segment is unitary with another under the Three Unities Test, the following additional general rules shall apply:
 - a. *Existence of Arms'-Length Prices*. The fact that goods and/or services are supplied at arms'-length prices between or among entities or segments of entities sought to be included in or excluded from a unitary business is

[ALTERNATIVE A] not a relevant fact, and does not support either inclusion in or exclusion from a unitary business group.

[ALTERNATIVE B] a relevant fact that is in support of exclusion from a unitary business group.

- b. *Non-Existence of Arms'-Length Prices.* The fact that goods and/or services are not supplied at arms'-length prices between or among entities or segments of entities sought to be included in or excluded from a unitary business is relevant, and is a fact that is in support of inclusion in a unitary business group.
- c. *Existence of Benefits from Joint, Shared or Common Activity.* The fact that a discount, cost-saving or other benefit can be shown to result from joint purchases, leaseholds or other forms of joint, shared or common activities between or among entities or segments of entities is relevant, and is a fact that is in support of inclusion in a unitary business group.
- d. *Non-Existence of Benefits from Joint, Shared or Common Activity.* The fact that a discount, cost-saving or other benefit cannot be shown to result from joint purchases, leaseholds or other forms of joint, shared or common activities between or among entities or segments of entities is not relevant, and is not a fact in support of either inclusion in or exclusion from a unitary business group.
- e. *Relationship of Joint, Shared or Common Activity to Income-Producing Operations.* In determining whether a joint, shared, or common activity is a fact that does or does not support a finding regarding unitary, consideration shall be given to the nature and character of the basic operations of each entity or segment. Such consideration shall include, but not be limited to, the entities' and segments' sources of supply, their goods or services produced or sold, their labor force and market to determine whether the joint, shared or common activity is directly beneficial to, related to or reasonably necessary to the income-producing activities of the unitary business.
- f. *The Existence or Lack of Control.*

[ALTERNATIVE A] The fact that control by one entity or segment over another entity or segment exists is relevant and is a fact in support of inclusion in a unitary business group.

[ALTERNATIVE B] The fact that control by one entity or segment over another entity or segment does not exist is relevant and is a fact in support of exclusion from a unitary business group.

[Alternatives A and B are to be coupled].

[ALTERNATIVE C] The fact that one entity or segment either exercises control or does not exercise control over another entity or segment is a fact to be taken into consideration in evaluating the significance of joint, shared, or common activity.

- g. *Stewardship Activities.* An investor who takes an action solely for its own benefit in overseeing its investment and which action is not taken to benefit the entity in which the investor owns an interest, shall be considered to be a stewardship” activity. The fact that stewardship activities exist is not relevant to determining whether the elements of “unity of operations” or “unity of use” have been satisfied.
- h. *Holding Companies and Diverse Businesses.* The test for a unitary business established hereunder shall be applied to determine whether a holding company is to be included in or excluded from a unitary group and to whether diverse businesses are to be included in or excluded from a unitary group. This provision applies irrespective of whether the holding company is an active or passive holding company.
- i. *Instant Unity; Presumptions*
 - (1) Newly-Acquired Corporations. When a corporation acquires another corporation,

a presumption shall exist against a finding of unity between the two corporations during the first reporting period. Any party may rebut such presumption by proving that the corporations were unitary. If such presumption is rebutted, then the corporations shall be considered unitary as of the date of acquisition, unless the evidence shows that unity was established as of another date.

(2) Newly-Formed Corporations. When a corporation forms another corporation, a presumption shall exist in favor of finding unity between the two corporations as of the date of formation. Any party may rebut such presumption by proving that the corporations were not unitary or that unity was established as of a later date.

- j. *Classifications of Activities between Unity of Operations and Unity of Use*. Certain activities conducted by an entity or segment may clearly be classified as either facts showing “unity of operations” or “unity of use”, while other activities may be classified under either one or both such unities. The fact that such activities can be so classified is not relevant. So long as such activities may reasonably be classified under either one or both such unities is relevant and is a fact in support of inclusion in a unitary business group.
- k. *Same General Line of Business; Presumption*. When the principal activities of the entities or segments are in the same general line of business, it shall be presumed, subject to rebuttal, that such entities and segments are unitary with one another. Illustrations of the same general line of business, but not limitations, are manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance.
 - (1) In determining whether two entities or segments are in the same general line of business, consideration shall be given to the nature and character of the basic operations of each entity or segment, including, but not

limited to, sources of supply, goods or services produced or sold, labor force and market.

(2) Two entities or segments are in the same general line of business when their operations are sufficiently similar to reasonably conclude that the entities or segments are likely to depend upon or contribute to one another.

- l. *Vertically Structured Business; Presumption.* When the principal activities of the entities or segments different steps of a vertically structured business, it shall be presumed, subject to rebuttal, that such entities and segments are unitary with one another. Illustrations of such different steps, but not limitations, are exploration, mining/drilling, production, refining, marketing, and/or transportation of natural resources.
- m. *Strong Centralized Management; Presumptions.* When there exists a strong centralized management with regard to the entities or segments, it shall be presumed, subject to rebuttal, that such entities and segments are unitary with one another. Illustrations of such management, but not limitations, are executive level policy decisions in the areas of purchasing, accounting, financing, tax compliance, legal services, human resources, health/retirement plans, product lines, capital investment, marketing and the like are determined by a central person or persons or committee and not by each entity or segment.
- n. *Segments within the Same Entity; Presumption.* When two or more business segments are within the same business entity, it shall be presumed, subject to rebuttal, that the segments are unitary with one another.

[Note: there has been support to eliminate this type of subparagraph as possibly duplicative of the previous subparagraphs, especially subparagraph l.]